confirmed and requested findings of fact and conclusions of law from the Debtors. Post-trial negotiations among the participants at the confirmation hearing resulted in proposed findings and a proposed confirmation order acceptable to all parties, including the committee. The proposed documents were received by the court on December 28, 2009. Because these documents are consensual, only minimal changes have been made by the court.

## FINDINGS OF FACT

### I. HAWAIIAN TELCOM BACKGROUND

#### A. History And Background.

1. Hawaiian Telcom has been operating for more than 125 years and is the incumbent local exchange carrier ("ILEC") for the State of Hawaii.[3]

2. Hawaiian Telcom is the largest telecommunications provider in Hawaii and offers a wide range of communications services throughout the State of

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3 Yeaman Direct ¶ 3; Reich Direct ¶ 10.

Docket No. 1343, Written Direct Testimony of Eric K. Yeaman ("Yeaman Direct"). Mr. Yeaman is the President and Chief Executive Officer of Hawaiian Telcom. Mr. Yeaman is responsible for all aspects of Hawaiian Telcom's business and operations, including Hawaiian Telcom's restructuring activities.

Docket No. 1356, Written Direct Testimony of Robert F. Reich ("Reich Direct"). Mr. Reich is the Senior Vice President, Chief Financial Officer and Treasurer of Hawaiian Telcom. He has held that position on an interim and then permanent basis since March of 2008. As Chief Financial Officer, Mr. Reich oversees all financial operations, including treasury, financial analysis and reporting, corporate and regulatory accounting, tax issues, risk management and investor relations.

Hawaii, including local exchange, long distance, network access, data and internet services, as well as wireless.[4]

3. Hawaiian Telcom is regulated by both the Hawaii Public Utilities Commission (the "HPUC") and the Federal Communications Commission (the "FCC").[5]

**B. Events Leading To The Chapter 11 Cases.**

4. In May 2005, The Carlyle Group acquired Hawaiian Telcom from Verizon Communications ("Verizon") in a $1.6 billion leveraged buy-out.[6] The Secured Lenders financed that transaction and, in exchange, obtained liens on substantially all of Hawaiian Telcom's assets, as further discussed below.[7]

5. After the acquisition, Hawaiian Telcom faced significant short and long-term challenges, including keeping pace with quickly-evolving telecommunications technologies and overcoming difficulties with the

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4 Yeaman Direct ¶ 3; Reich Direct ¶ 10.

5 Reich Direct ¶ 11.

6 Reich Direct ¶ 12.

7 See Debtors' Exhs. 5-9, consisting of the relevant 2005 credit and security agreements and the 2007 credit and security agreements, which amended the 2005 credit and security agreements.

transition of certain back-office functions from Verizon.[8]

6. Hawaiian Telcom also realized it would have difficulty satisfying its capital expenditure needs while meeting its debt servicing requirements.[9] Indeed, as of December 1, 2008 (the "Petition Date"), Hawaiian Telcom's liabilities included: (a) $589.5 million (plus accrued interest) in connection with the senior secured credit facility and certain secured swap agreements; (b) $350 million (plus accrued interest) on account of the Senior Notes; (c) $150 million (plus accrued interest) on account of 12.5% subordinated notes; and (d) approximately $45 million of trade obligations and other general unsecured claims.[10]

7. The overleveraged capital structure made it difficult for Hawaiian Telcom to compete effectively with Oceanic Time Warner, its primary competitor.[11]

### C. Hawaiian Telcom's Restructuring Efforts.

8. In 2008, Hawaiian Telcom hired a new management team in an effort to explore all strategic opportunities and to improve operating results.[12] As

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8 Reich Direct ¶ 12.

9 Reich Direct ¶ 12.

10 Ex. D-2 at 42 (Disclosure Statement).

11 Reich Direct ¶ 72.

12 Reich Direct ¶ 14.

part of the management efforts to explore all available opportunities, Hawaiian Telcom retained Zolfo Cooper LLC ("Zolfo Cooper") and Lazard as advisors.[13]

### 1. Hawaiian Telcom's Strategic Business Plan and Next Generation Television.

9. The new management team developed a revised strategic business plan that will allow Hawaiian Telcom to compete and succeed in the rapidly changing and competitive telecommunications industry.[14] The business plan focuses on introducing new products, simplifying existing product offerings, improving customer service, leveraging network infrastructure, improving processes and systems and rebuilding customer confidence.[15]

10. One key component of Hawaiian Telcom's business plan is to become a leading provider of Next Generation Television ("NGTV").[16] NGTV is a critical product for Hawaiian Telcom to be able to effectively compete with Oceanic Time Warner in offering bundled services.[17]

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13 Reich Direct ¶¶ 15, 17.

14 Reich Direct ¶ 69.

15 Reich Direct ¶ 69; see also November 9, 2009 Confirmation Trial Transcript ("Tr.") at 73:19-20 (Reich testimony) (stating that the business plan involves "expanding the capabilities of the network").

16 Reich Direct ¶ 72.

17 Reich Direct ¶ 72; Edl Direct ¶ 11.

(Continued...)

11. Hawaiian Telcom's financial projections show positive growth in NGTV in 2011.[18] Without a successful launch of NGTV, Hawaiian Telcom is less likely to reach positive net income in 2011 as projected.

12. Hawaiian Telcom's main competitor, Oceanic Time Warner, currently offers a bundled "triple play" product where customers receive telephone services, broadband internet and digital television through one company.[19]

13. While NGTV is an important part of the business plan, Hawaiian Telcom's launch of NGTV faces many technical and logistical hurdles, including (a) the need to obtain certain regulatory approvals for NGTV and to ensure that NGTV's launch will be able to comply, economically, with all regulatory requirements; (b) the need to design, implement, deploy, integrate and/or test of significant network equipment and IT systems related to the provision of NGTV; (c) the need to design, develop and/or enhance the Company's provisioning, billing, accounting, business intelligence and reporting systems to incorporate and support NGTV and bundled products, as well as

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Docket No. 1345, Written Direct Testimony of Michael F. Edl ("Edl Direct"). Mr. Edl is the Senior Vice President for Network Services at Hawaiian Telcom. He leads the group that operates Hawaiian Telcom's network, and the Network Services group is responsible for Engineering, Planning and Construction, Network Reliability, Field Operations, Operations Support and Provisioning. Mr. Edl joined the company in August 2008. Edl Direct ¶ 11.

18 Reich Direct ¶ 59.

19 Edl Direct ¶ 10.

marketing and sales promotions, packages and special offers; (d) the need to train sales, customer support, technical support, field support and network support staff; and (e) the need to complete a trial deployment of approximately 200 premise installations.[20] Hawaiian Telcom's NGTV product offering will also face serious competitive challenges from Oceanic Time Warner, one of the most entrenched incumbent cable providers in the entire United States.[21]

14. The Committee did not challenge Hawaiian Telcom's business plan or future growth strategy during the trial. It did not contend that Hawaiian Telcom's

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20 Edl Direct ¶ 12; Reich Direct ¶ 79; Melton Direct ¶ 75; Wilson Direct ¶ 26-27.

Docket No. 1358 Written Direct Testimony of J. Nicholas Melton, Lazard Frères & Co., LLC, ("Melton Direct"). Mr. Melton is a Managing Director of Lazard. Mr. Melton has provided professional services in a variety of telecommunications industry transactions, including mergers and acquisitions, restructurings and public and private financings and has more than 15 years of relevant work experience. Melton Direct ¶¶ 6, 7. Mr. Melton provided an expert opinion regarding the Debtors' enterprise value.

Docket No. 1361 Declaration of Christopher Wilson in Support of Secured Lenders' Memorandum of Law in Support of Joint Chapter 11 Plan of Reorganization of Hawaiian Telcom Communications, Inc. and Affiliated Debtors ("Wilson Direct"). Mr. Wilson is a Managing Director and head of the Media & Telecommunications Group at of Houlihan Lokey Howard & Zukin Capital, Inc. ("Houlihan"), an international investment bank retained by Weil, Gotshal & Manges LLP ("WGM"), counsel to the Secured Lenders. Wilson Direct ¶ 1. Mr. Wilson was admitted as the Secured Lenders' valuation expert on the Debtors' total enterprise value and the value of the proposed warrants under the Plan. Mr. Wilson's expertise includes the valuation of business entities and their debt and equity instruments, and has advised various constituencies in numerous reorganizations and distressed situations. Wilson Direct ¶ 3.

21 Edl Direct ¶ 12; Reich Direct ¶ 80; Melton Direct ¶ 75; Wilson Direct ¶ 25.

business plan is unreasonable, was not properly developed or did not account for the potential growth or certain challenges associated with new technologies.[22]

### 2. Out-Of-Court Efforts To Delever The Capital Structure.

15. Under the direction of the new management team, and with Lazard's assistance, Hawaiian Telcom also undertook substantial out-of-court efforts in 2008 to effectuate a balance sheet restructuring.[23] Hawaiian Telcom contacted the Senior Noteholders, the Secured Lenders and The Carlyle Group, among others.

16. In October 2008, Hawaiian Telcom's management and advisors approached the Senior Noteholders with a proposal that would have provided the Senior Noteholders an opportunity to invest in the company at an implied value of approximately $500 million. The Senior Noteholders declined.[24] At the same time, Lazard began soliciting third party interest in a potential

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22 November 13, 2009 Tr. at 208:1-7 (Committee Counsel argument) (stating that the Committee is not challenging "the feasibility of the [P]lan").

23 Yeaman Direct ¶ 4; Reich Direct ¶ 21.

24 Reich Direct ¶ 19; November 9, 2009 Tr. at 52:10-53:6 (Yeaman testimony); Melton Direct ¶ 76.

financing and/or strategic investment transaction.[25]

17. Ultimately, the Debtors were unable to consummate an out-of-court restructuring.[26]

**D. The Chapter 11 Cases.**

18. On the Petition Date, December 1, 2008, the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. The Debtors have continued to operate their businesses and manage their properties as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.[27]

**1. The Cash Collateral Order.**

19. Hawaiian Telcom has financed the chapter 11 cases using cash on hand, which constitutes the cash collateral of the Secured Parties under section 363 of the Bankruptcy Code. After resolving the Committee's objections to the use of cash collateral and related adequate protection consensually, the Debtors, the Secured Parties and the Committee agreed upon the terms of the final cash collateral order, dated January 16, 2009, as amended and

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25 Ex. D-2 at 48 (Disclosure Statement) ("Prior to the commencement of the chapter 11 cases, Lazard contacted approximately 12 institutions including four strategic investors and eight financial investors.").

26 Reich Direct ¶ 21.

27 Reich Direct ¶ 21.

supplemented.[28]

20. Pursuant to the Cash Collateral Order as modified by the first order extending the Cash Collateral Order entered on February 27, 2009, [Docket No. 478], Hawaiian Telcom has made and must continue to make, *inter alia*, adequate protection payments to the Secured Parties in cash in an amount equal to postpetition interest at the non-default rate on $300 million of prepetition secured claims.[29] Adequate protection payments equal to interest on the Secured Parties' claims in excess of $300 million, to the extent allowed, have been paid in kind and added to the Secured Parties' prepetition claims, without prejudice to the Secured Parties' claim for interest at the default rate.[30] Pursuant to the Cash Collateral Order, Hawaiian Telcom has also made and must continue to make adequate protection payments in an amount equal to all fees and expenses due under the Prepetition Financing Documents (as defined in the Cash Collateral Order), including the fees and expenses of the Secured Parties' legal counsel

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28 Docket No. 291, Final Order (I) Authorizing Use of Cash Collateral Pursuant to Section 363 of Bankruptcy Code, and (II) Providing Adequate Protection to Prepetition Secured Lenders Pursuant to Sections 361, 362 and 363 of Bankruptcy Code, dated January 16, 2009, together with each of the subsequent extensions and amendments thereto (the "Cash Collateral Order").

29 Cash Collateral Order, ¶ 9(c).

30 Cash Collateral Order ¶ 9(c).

and other professionals.[31]

21. Moreover, "[d]uring the period the Debtors use cash collateral ... no administrative claims ... shall be charged or assessed against or recovered from the Collateral or attributed to the Prepetition Secured Parties with respect to their interests in the Collateral pursuant to the provisions of section 506(c)."[32]

22. Section 9 of the Cash Collateral Order is clear that the Secured Parties were entitled to adequate protection for any and all diminution in the value of the Collateral, and provides, in relevant part:

> The [Secured Parties] are entitled, under section 363(e) of the Bankruptcy Code, to adequate protection with respect to their interest in the [collateral], for and equal in amount to the aggregate diminution in value of the [Secured Parties'] interests in the [collateral], including any such diminution resulting from (a) the use of Cash Collateral, (b) the sale, lease, or use by the Debtors (or other decline in value) of the [collateral], and (c) the imposition of the automatic stay under section 362 of the Bankruptcy Code.[33]

23. Pursuant to the terms of the Cash Collateral Order, "[a]dequate Protection Payments shall be subject to any parties' rights to seek recharacterization ...

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31 Cash Collateral Order, ¶ 9(c).

32 Cash Collateral Order ¶ 5(b).

33 Cash Collateral Order ¶ 9

of such payments as payments in satisfaction of principal amounts due under the Prepetition Financing Documents." [34]

### 2. Operations During Chapter 11.

24. Throughout the chapter 11 cases, Hawaiian Telcom has continued to operate and improve its network, through capital expenditures ("capex") aimed at enhancing existing products, developing new products, improving back-office and IT systems, and necessary maintenance and repair of the network.[35]

### 3. Development Of The Plan.

25. After the Petition Date, Lazard continued to market Hawaiian Telcom to potential purchasers. From September 2008 through the confirmation proceeding, Lazard contacted approximately 38 institutions, including 13 strategic investors and 25 financial investors. Several potential investors, including strategic purchasers, submitted formal indications of interest to acquire Hawaiian Telcom for approximately $300 to $400 million. No deal was completed.[36]

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34 Cash Collateral Order ¶ 9(c)

35 Reich Direct ¶¶ 72-73.

36 Melton Direct ¶ 76.

26. Prior to engaging the Secured Lenders in Plan negotiations, Hawaiian Telcom conducted an independent review of the Secured Parties' liens. Hawaiian Telcom concluded that the Secured Parties have liens on and security interests in substantially all of the assets of the Debtors' businesses, including substantially all of the Debtors' cash and all equipment, fixtures, accounts receivable, all intangibles (including brand names, intellectual property, customer lists and relationships, and goodwill) and major buildings.[37]

27. The outcome of the Debtors' lien analysis is consistent with the Court's August 20, 2009 ruling that the Secured Parties have perfected liens in the Debtors' "personal property" that "is described in Section 4.01 of the

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[37] Reich Direct ¶ 22; Nystrom Direct ¶¶ 22-23; November 13, 2009 Tr. at 16:7-12 (Schaeffer Testimony) (recognizing certain aspects of the Seeured Parties' collateral package through estimate of value of the encumbered tangible assets); id. at 19:11-17 (recognizing certain aspects of the Secured Parties' collateral package related to encumbered intangible assets).

Docket No. 1357, Written Direct Testimony of Kevin Nystrom ("Nystrom Direct"), ¶¶ 1, 22-23. Mr. Nystrom is the Chief Operating Officer of Hawaiian Telcom and is also a Managing Director at Zolfo Cooper. Mr. Nystrom first worked on the Hawaiian Telcom engagement when Hawaiian Telcom engaged Zolfo Cooper to assist the company with its restructuring in February 2008. Nystrom Direct ¶ 2. Mr. Nystrom testified on both November 9, 2009 and November 12, 2009.

Mr. Schaeffer was admitted as the Committee's valuation expert, specifically, on the Debtors' total enterprise value and on the proposed warrants under the Plan. Docket No. 634 Declaration of Luke Schaeffer in Support of the Objection of the Official Committee of Unsecured Creditors of Hawaiian Telcom Communications, Inc., to Confirmation of the Joint Chapter 11 Plan of Reorganization of Hawaiian Telcom Communications, Inc. and Its Debtor Affiliates ("Schaeffer Direct") ¶ 7.

Amended and Restated Collateral and Guarantee Agreement," dated as of June 1, 2007 and as supplemented by Supplement No. 1, dated as of October 24, 2008, except for the Debtors' motor vehicles; the Debtors' "Encumbered Real Property described in The Amended and Restated Mortgage," dated as of June 29, 2007; the Debtors' "fixtures located on the Encumbered Real Property"; and the Debtors' "fixtures that are not attached to the Encumbered Real Property."[38] The Court found that there was a genuine issue of material fact as to the perfection of the Secured Parties' lien on the funds in Hawaiian Telcom's deposit accounts at First Hawaiian Bank and the Bank of Hawaii.[39] The Court assumed for the purpose of the confirmation hearing that the Secured Parties' liens on such funds are valid and perfected.[40]

28. Based on its analysis of the Secured Parties' liens and security interests and their senior position in the capital structure, Hawaiian Telcom identified the

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38 Adversary Proceeding, Case No. 09-90023, Docket No. 69, at 2-3 (August 20, 2009 Order Granting In Part and Denying In Part Plaintiff's Motion for Summary Judgment).

39 Id.

40 November 13, 2009 Tr. at 173:6-14 (statements by the Court) ("[U]nless something is declared invalid . . . we assume for the purposes of this hearing, and I have been assuming, that you have a security interest.").

Secured Parties as the key economic stakeholders in Reorganized Hawaiian Telcom with which to negotiate a plan of reorganization.[41]

29. In March 2009, Hawaiian Telcom and the Secured Lenders, with their respective advisors, began the negotiations that led to the Plan. The Plan is the product of good faith arm's length negotiations between, among other entities, Hawaiian Telcom and the Secured Lenders.[42]

30. The negotiations were time consuming, but resulted in a Plan that accomplishes the goals Hawaiian Telcom detailed at the outset of these cases. The Plan maximizes value for all creditors, significantly deleverages the capital structure, will enable Hawaiian Telcom to implement its business plan and is worthy of the required regulatory approvals from the FCC and the HPUC.[43]

31. Hawaiian Telcom developed the Plan with the goal of maximizing value for all creditors. As a result of Hawaiian Telcom's efforts, the Secured Parties agreed to waive their deficiency claim.[44] In addition, the Secured Parties waived their right to any recovery from the successful pursuit of avoiding

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41 Nystrom Direct ¶ 24; Reich Direct ¶¶ 54-55.

42 Nystrom Direct ¶ 24; Reich Direct ¶¶ 54-55.

43 Nystrom Direct ¶ 24; Reich Direct ¶¶ 54-55.

44 Reich Direct ¶ 24.

power and other claims of Hawaiian Telcom's estates arising under chapter 5 of the Bankruptcy Code. Doing so allowed Hawaiian Telcom to provide a greater recovery to the unsecured creditors under the Plan.[45]

32. Throughout these chapter 11 cases Hawaiian Telcom provided for an open and transparent process. While negotiating with the Secured Lenders, Hawaiian Telcom's management team and advisors maintained open dialogues with other key constituents, including the Committee, the HPUC and the International Brotherhood of Electrical Workers, Local 1357 ("IBEW").[46]

33. Hawaiian Telcom's negotiation of the Plan was in good faith and resulted in a Plan that is fair and equitable to all creditors.[47]

## II. THE PRIMARY CONTESTED ISSUES AT CONFIRMATION.

34. The Debtors' Plan is based upon the range of enterprise values determined by Lazard.[48] Recoveries under the Plan are based upon the Debtors'

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45 Mandava Direct ¶ 13.

Docket No. 1347, Written Direct Testimony of Suneel Mandava, Lazard Frères & Co., LLC ("Mandava Direct"). Mr. Mandava is a Director at Lazard and a FINRA Series 7 licensed General Securities Registered Representative, has passed the Certified Public Accountant's exam, and has served in a variety of analyst and consultant position and has over 14 years of relevant work experience. Mandava Direct ¶ 8. Mr. Mandava provided expert opinion regarding the use and value of warrants under the Plan as well as the recoveries under the Plan.

46 Nystrom Direct ¶ 24.

47 Yeaman Direct ¶ 7; Reich Direct ¶ 16; Nystrom Direct ¶¶ 45-46.

prepetition capital structure as supplemented by the Debtors' negotiations with the Secured Lenders.

35. The Committee objected to the Debtors' Plan on four primary grounds: (a) the Debtors' total enterprise value of Hawaiian Telcom, (b) the value of the Debtors' unencumbered assets, (c) the value and utility of warrants provided to the Senior Noteholders, and (d) the allocation of value between the Secured Parties and the unsecured creditors. Each area is addressed herein. Additionally, the Committee argued in its objection to confirmation that the Debtors did not propose the Plan in good faith, which is addressed in section I, supra, and section II.E, infra.

**A. The Debtors' Enterprise Value.**

36. Each of the Debtors, the Secured Lenders, and the Committee retained an expert witness to determine the total enterprise value ("TEV") of Hawaiian Telcom's businesses. Specifically, Lazard determined Hawaiian Telcom's TEV on behalf of the Debtors, Houlihan on behalf of the Secured Lenders, and Mr. Schaeffer of FTI on behalf of the Committee.

37. While all three parties' experts used the same valuation methodologies, the Committee's expert's valuation was higher than both (a) the valuations

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48 Ex. D-2 at 60-61 (Disclosure Statement).

reached by both the Debtors' and the Secured Lenders' experts, and (b) several market-based indicators of value. For the reasons set forth in this section, the Court accepts Lazard's total enterprise valuation.

### 1. The Debtors' Range of Enterprise Value Is Reasonable.

#### (a) The Debtors' Range Of Enterprise Value Is Between \$350 And \$425 Million.

38. The Debtors' TEV is \$387.5 million. The Debtors' Total Distributable Value ("TDV") is \$460 million.[49] TDV is calculated by adding to TEV \$52 million of cash on hand after administrative expenses and \$20 million of non-core assets.[50] All three valuation experts employed the three commonly accepted valuation methodologies, namely (a) the comparable company analysis, (b) the precedent transaction analysis, and (c) the discounted cash flow ("DCF") analysis.[51]

39. The lower end of the Lazard TEV range reflects the "market's likely . . . skepticism toward future prospects of the company . . . that's the \$350 million range." The high end of the range, the \$425 million range, reflects

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49 Melton Direct ¶ 3.

50 Melton Direct ¶ 3.

51 Melton Direct ¶ 3; Schaeffer Direct ¶ 26; Wilson Direct ¶ 32.

"an appreciation . . . for management's execution of [its] turnaround strategy."[52]

### (b) The Lazard Enterprise Value Range Is Consistent With Houlihan's Analysis.

40. Lazard's TEV opinion is supported by the Secured Lenders' valuation expert, Houlihan, which determined that Hawaiian Telcom's TEV was $400 million and TDV was $420 million.[53]

### (c) The Enterprise Value Range Is Consistent With The Market's View of Hawaiian Telcom.

41. Lazard marketed Hawaiian Telcom to 38 potential investors during Hawaiian Telcom's restructuring efforts. From those efforts, "nobody submitted an indication of interest in excess of Lazard's enterprise valuation. Rather, potential investors, including strategic purchasers, submitted formal indications of interest to acquire Hawaiian Telcom for approximately $300 to $400 million."[54] Houlihan also considered this range of indications of

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52 November 10, 2009 Tr. at 24:19-25:2 (Melton testimony).

53 Wilson Direct ¶ 8.

54 Melton Direct ¶ 76 ("Indeed, none of these indications of interest have demonstrated that Hawaiian Telcom has a value greater than the value found by Lazard"). See also November 13, 2009 Tr. at 11:20-14:19 (Schaeffer testimony) (testifying that he recalled indications of interest higher than $400 million, but could not recall the precise amounts).

interest to be indicative of the true market value of Hawaiian Telcom's TEV.[55]

42. Lazard's marketing effort provides "an interesting data point" in determining whether the ultimate valuation makes "sense."[56]

43. It is appropriate to examine market indications of interest in the context of current market environments to the extent they are available in determining the reasonableness of a valuation.

44. The market valuation of Hawaiian Telcom based on the trading prices of its debt, at $385.9 million, is also less than Lazard's enterprise valuation.[57] This fact further corroborates the multitude of evidence demonstrating that Hawaiian Telcom's TEV does not exceed the Plan's assumed TEV.

### 2. All Valuation Experts Utilized Common Enterprise Valuation Methodologies.

45. The comparable company analysis values Hawaiian Telcom based on the valuation of comparable publicly traded companies.[58] This analysis estimates how "the stock market would value this company."[59]

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55 Wilson Direct ¶ 66.

56 November 10, 2009 Tr. at 84:20-85:3 (Melton testimony).

57 Wilson Direct ¶ 67.

58 Melton Direct ¶ 19; Wilson Direct ¶ 32.

59 November 10, 2009 Tr. at 20:16-20 (Melton testimony).

46. The precedent transaction analysis is based on what other companies have been willing to pay for similar companies in a market transaction.[60] This analysis estimates the value of Hawaiian Telcom in a mergers and acquisitions context.[61]

47. The DCF analysis is based on Hawaiian Telcom's financial projections and the net present value of the projected future cash flows.[62] "The discounted cash flow analysis is reflective of the management's plan."[63] The DCF methodology uses Hawaiian Telcom's management's projections and discounts the cash flows to present value.

### 3. Lazard Exercised Appropriate Judgment In Evaluating The Debtors' Enterprise Value.

#### (a) Lazard Properly Accounted For Hawaiian Telcom's Performance Relative To Peer Companies.

48. Hawaiian Telcom's financial and operational performance are important factors to analyze to determine enterprise value.[64] When the financial and

60 Melton Direct ¶ 44.

61 November 10, 2009 Tr. at 22:15-23:2 (Melton testimony).

62 Melton Direct ¶ 58.

63 November 10, 2009 Tr. at 23:17-24:5 (Melton testimony).

64 Melton Direct ¶¶ 13, 20, 55.

operational metrics are properly considered, Hawaiian Telcom should be valued on the low end of its peer group.[65]

49. Hawaiian Telcom's management's financial projections are lower than the financial projections for peer companies in the following categories: (a) 2009 expected EBITDA Margin; (b) 2009 expected free cash flow margin; (c) 2009 expected EBITDA growth; and (d) monthly EBITDA per access line.[66]

50. Hawaiian Telcom also performs below its peers in certain operating metrics. Hawaiian Telcom is below many of its peer companies in the following categories: (a) access lines per square mile – Hawaiian Telcom has more than many peer companies, indicating the density of the population served; (b) receipt of Universal Service Fund ("USF") subsidies – Hawaiian Telcom receives none; (c) cable overlap – Hawaiian Telcom, unlike most peer companies, has competition from cable for phone service in 100% of its service area; and (d) digital subscriber line ("DSL") penetration – only 20% of Hawaiian Telcom's access lines subscribe to its DSL service. Hawaiian Telcom's low rate of DSL penetration is of concern because in deploying

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65 Melton Direct ¶ 24 ("[T]his range of multiples for Hawaiian Telcom is appropriate given its positioning relative to the comparable companies"); Wilson Direct ¶ 40-41.

66 Melton Direct ¶ 37; Wilson Direct ¶ 40.

NGTV, Hawaiian Telcom will need to leverage its DSL base to "push that product through."[67]

51. Based on Hawaiian Telcom's financial and operating performance compared to its peers, it is appropriate to value Hawaiian Telcom at the low end of the range indicated by comparable company and precedent transaction multiples. "[T]he bottom of the range reflects, frankly, the under-performance of the company relative to its peers, particularly on a free-cash-flow generation basis, as well as a number of other metrics that we examined."[68]

**(b) Lazard's Valuation Is Supported By Hawaiian Telcom's Free Cash Flow Performance Metric.**

52. Free cash flow is a particularly relevant financial metric for Hawaiian Telcom and Hawaiian Telcom's free cash flow generation is lower than many of its peers.[69]

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67 November 10, 2009 Tr. at 50:7-13 (Melton testimony); Melton Direct ¶ 41.

68 November 10, 2009 Tr. at 21:8-15 (Melton testimony). The Secured Lenders' expert witness took an even less optimistic view of Hawaiian Telcom's performance, noting that Hawaiian Telcom finished in the bottom half of nine different categories. Wilson Direct ¶ 40.

69 Melton Direct ¶ 26; see also November 10, 2009 Tr. at 34:6-12 (Melton testimony) ("[T]he basic equation for determining the value of a company is what is the cash-flow-generation ability of that company? What is the risk associated with those cash flows? And that's the fundamental building block of value."); November 10, 2009 Tr. at 33:25-34:2 (Melton testimony) ("[A] company that generates less money is worth less than the company that generates more money"); November 10, 2009 Tr. at 33:15-17 (Melton (Continued...)

53. All three valuation experts measured free cash flow as EBITDA minus capex.[70] "EBITDA is revenue minus your cash operating expenses for the company. And then you take out your capital expenditures. That's the amount of cash the company is producing."[71]

54. Hawaiian Telcom has relatively low EBITDA margins and relatively high capex, resulting in lower free cash flow margins than many comparable companies.[72] Hawaiian Telcom's EBITDA margins are lower than those of comparable companies for several reasons, including: (a) Hawaiian Telcom does not receive federal subsidies; (b) Hawaiian Telcom's revenue per access line is below that of its peers, reflecting Hawaiian Telcom's challenging competitive market; and (c) Hawaiian Telcom has relatively high labor costs.[73]

55. Hawaiian Telcom's capital expenditures are relatively higher than those of its peers because, among other things: (a) the salt water environment

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testimony); Wilson Direct ¶ 13; November 12, 2009 Tr. at 33:4-13 (stating that free cash flow is the "most important" measure of a company's profitability).

70 November 10, 2009 Tr. at 35:5-17 (Melton testimony); Wilson Direct ¶ 13; Schaeffer Direct ¶ 44. "Q. And do you agree with me that those, that free cash flow is an important metric to consider in valuing a company. A. It's, it's an important metric." November 13, 2009 Tr. at 40:19-22 (Schaeffer testimony).

71 November 10, 2009 Tr. at 33:8-12 (Melton testimony).

72 Melton Direct ¶¶ 27-29; Wilson Direct ¶ 13-14.

73 Melton Direct ¶ 28 ; November 10, 2009 Tr. at 37:2-25 (Melton testimony).

corrodes its plant, property and equipment; (b) Hawaiian Telcom has more central offices per access line; (c) it is more difficult to maintain a network because Hawaii is comprised of multiple islands; and (d) Hawaiian Telcom's predecessor owners, GTE and Verizon, deployed less modern equipment in Hawaii.[74]

56. Given that Hawaiian Telcom's cash flow generation ability is "much lower than its peers," the EBITDA multiple has to be informed by the free cash flow multiple.[75]

### (c) Lazard's DCF Analysis Accounted For Hawaiian Telcom's Management's Projections Without Ignoring Market Risks.

57. The upper end of Lazard's TEV range accounts for Hawaiian Telcom's management's business projections.[76] This "reflects the possibility that the market will begin to appreciate the company's execution of . . . its strategy."[77]

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74 Melton Direct ¶ 29; November 10, 2009 Tr. at 35:25-37:1 (Melton testimony); Edl Direct ¶ 8; Wilson Direct ¶ 13.

75 November 10, 2009 Tr. at 58:23-59:1 (Melton testimony); see also November 10, 2009 Tr. at 33:18-22 (Melton testimony) ("If you are applying an EBITDA multiple without considering the cash generation of the business then . . . you will incorrectly apply that EBITDA multiple."); Wilson Direct ¶ 13.

76 November 10, 2009 Tr. at 69:20-70:17 (Melton testimony).

77 November 10, 2009 Tr. at 21:16-18 (Melton testimony).

58. Lazard's TEV range is not the same as its DCF range.[78] This is justified in part because Hawaiian Telcom faces both implementation and market challenges in implementing its business plan.[79] The ultimate TEV range captures "the possibility that the strategy is successful, despite all the risks."[80]

59. The Court finds that Mr. Melton's methodology, opinions and conclusions are persuasive and Mr. Melton was a credible expert. In addition to Mr. Melton's written direct testimony, Mr. Melton appeared in Court and was cross examined by counsel for the Committee. Many of Mr. Melton's assumptions and conclusions were corroborated by the testimony of the Secured Lenders' expert, Mr. Wilson. Mr. Melton's testimony on cross examination was credible.

**B. The Debtors Properly Valued The Unencumbered Assets.**

60. Under the Plan, the unsecured creditors' recovery is a function of the value of the unencumbered assets. Hawaiian Telcom analyzed the value of the motor vehicle fleet, the unencumbered real property, and certain of Hawaiian Telcom's easements and determined that the value of those

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78 November 10, 2009 Tr. at 25:4-9 (Melton testimony).

79 November 10, 2009 Tr. at 30:11-32:11 (Melton testimony).

80 November 10, 2009 Tr. 25:10-17 (Melton testimony).